

**Securities Industry Association**

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August 17, 1998

Joan Conley
Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

Re: NASD Notice to Members 98-42

Dear Ms. Conley:

The Federal Regulation Committee and the Self-Regulation and Supervisory Practices Committee (the "Committees") of the Securities Industry Association ("SIA")¹ appreciate this opportunity to comment on the proposal to grant temporary cease and desist authority to the enforcement staff of NASDR.

The Committees applaud NASDR's efforts to address serious broker-dealer and salesperson misconduct but believe that the proposal is unwarranted in that NASDR has not demonstrated a need for such extraordinary power. Moreover, the Committees believe that regulators currently have adequate tools at their disposal to respond to significant fraudulent activity. We believe that the injunctive authority available to the SEC and state securities agencies, as well as the authority granted to the SEC for temporary cease and desist orders pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Act"), provides ample protection of public investors in those rare situations where emergency action is warranted. In addition, NASD suspension procedures provide an effective, if not immediate, tool to respond to any instance of a member's failure to cooperate with the NASD.

In the Notice To Members, NASDR acknowledges that temporary cease and desist actions would constitute "extraordinary proceedings" and attempts to ensure that the authority is applied appropriately by providing the procedural safeguard of prior written authorization by the President or Chief Operating Officer of NASDR. While this ensures that the prosecutorial judgment for such extraordinary proceedings is made at the highest staff levels, the Committees nevertheless believe that any grant of such admittedly extraordinary power should be based on a demonstrable need and a showing that existing enforcement tools are inadequate to protect the investing public. The Notice does not provide any record--either statistical or anecdotal--which makes this case. Although the release at one point refers to the proposed

microcap rules, there is no attempt in the discussion to limit the scope of the cease and desist authority to the problems of that market. In fact, the broad list of rules for which the authority is requested appears to extend well beyond the NASD's stated purpose of addressing only "those rule violations that pose the most serious and immediate investor protection concerns." The Committees are particularly concerned that temporary cease and desist authority could be applied in areas that are dependent on facts and circumstances and where irreparable harm may result if precipitous action is taken.

It appears from the Notice that NASDR staff recognize that the instances that would warrant cease and desist proceedings would be rare. The Committees submit that ample authority already exists in the regulatory environment for taking prompt action in those rare cases. For example, in addition to the NASD's own early intervention capability described above, the SEC or states can seek an injunction in a court of law, or the SEC can issue a temporary cease and desist order under Section 21C of the Act. Recent actions indicate that the courts are able to respond promptly when the SEC demonstrates the existence of an ongoing fraud, or the imminent dissipation or transfer of customer funds. See *SEC v. Assoc. for Individual Ministries*, S.D.N.Y., 98 Civ. 4840 (RPP), July 9, 1998 and *SEC v. American Automation, Inc.*, N.D. Texas, 3-98CV1596-D, July 10, 1998, reported in 29 BNA Sec. Reg. & L. Rept., July 17, 1998 at p. 1084. To grant NASDR authority similar to that which the SEC acquired through an act of Congress would be redundant.² Indeed, those wrongdoers engaged in the most egregious offenses are often impervious to administrative proceedings and are only deterred by the threat of a contempt proceeding.

SEC Commissioner Laura Unger has just concluded a review of the SEC Division of Enforcement policies and priorities, and has recommended that the Division make it a key priority to intensify coordination of enforcement efforts with SROs by working more closely with them.³ Accordingly, where NASDR staff perceive an imminent danger to the investing public of the kind that requires emergency action, the proper course of action would be for them to bring the matter to the attention of the SEC enforcement staff for initiation of injunctive proceedings, or a temporary cease and desist action. Alternatively, NASDR staff could coordinate such action with state regulatory agencies, which have also intensified their focus on "microcap fraud."

Finally, while the proposal characterizes the relief sought as "temporary," in fact, the statutory procedure for review of NASD enforcement actions could result in the permanent destruction of legitimate business enterprises, based solely on staff allegations, as seconded by the President (or COO) of NASDR. No other private body has the power to exercise such an economic taking. Indeed, when Congress gave temporary cease and desist authority to the SEC, it provided for immediate review before a U.S. District Court.⁴ Under Section 19 of the Act (as referenced in proposed Rule 9870) and accepted standards of administrative review, no such relief would be available to the subject of an NASD "temporary" order. The respondent would first have to seek relief from the NASDR hearing panel (in contrast to the independent court review of an SEC cease and desist order). The respondent would have to exhaust its remedies within NASDR, then seek relief from the SEC, and only then appeal the SEC order to a U.S. Court of Appeals under Section 25 of the Act. No business organization is likely to survive the marathon efforts needed to reverse such a "temporary" order.

In conclusion, the Committees do not believe that it is necessary, or in the public interest, for

the NASDR to replicate every enforcement tool that is available to federal and state regulatory agencies. Where its investigations give rise to a need for emergency action, NASDR should seek such action through cooperation with those agencies whose statutory structure provide reasonable due process protections for those who may become the subject of misapplied or overzealous discretion.

Thank you for giving the Committees the opportunity to comment. If we can provide additional information or if you would like to discuss our views further, please contact the undersigned or Scott Kursman, Staff Advisor to the Federal Regulation Committee, or Judith Poppalardo, Staff Advisor to the Self-Regulation and Supervisory Practices Committee, at 212-608-1500 and 202-296-9410, respectively.

Respectfully submitted,

Lee B. Spencer, Jr.
Chairman
Federal Regulation Committee

R. Gerald Baker
Chairman
Self-Regulation and Supervisory
Practices Committee

Footnotes:

¹ The Securities Industry Association ("SIA") brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members—including investment banks, broker-dealers, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans, and accounts for \$270 billion of revenues in the U.S. economy.

² Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. Law 101-429.

³ See SEC press release 98-64, July 16, 1998.

⁴ Securities Exchange Act 21C(d)(2)(A).